91-1527

Supreme Court, U.S.
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NO.

# IN THE SUPREME COURT OF THE UNITED STATES

**OCTOBER TERM, 1991**

In Re: WALTER LEADBETTER,
*Debtor*

MARVIN A. SICHERMAN, TRUSTEE
*Plaintiff-Respondent*

v.

THE OHIO PUBLIC EMPLOYEES DEFERRED COMPENSATION PROGRAM
*Defendant-Petitioner*

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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## QUESTION PRESENTED

If an account established pursuant to 26 U.S.C. Sec. 457 constitutes a legal or equitable interest as used in 11 U.S.C. 541(a)(1), under 11 U.S.C. 541(c)(2), in which the bankruptcy court is to give effect to "applicable nonbankruptcy law" in determining what assets constitute the estate in bankruptcy, should the bankruptcy court give effect to the provisions of 26 U.S.C. 457(b)(6) and state law which require that funds held for an employee pursuant to a deferred compensation program shall remain "solely the property and rights of the employer" until that employee attains age 70 and 1/2, separates from service, or sustains an unforeseeable emergency?

## LIST OF PARTIES

The parties to the proceedings and in this court are the defendant-petitioner Ohio Public Employees Deferred Compensation Program, and the plaintiff-respondent Marvin A. Sicherman, Trustee in Bankruptcy.

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

---

The Petitioner Ohio Public Employees Deferred Compensation Program respectfully requests that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Sixth Circuit, entered in the above entitled proceedings on October 21, 1991.

## OPINIONS BELOW

The unpublished October 21, 1991, per curiam opinion of the Court of Appeals for the Sixth Circuit, review of which is sought by this petition, is reprinted in the appendix hereto beginning at p. A-1. That opinion was followed by an unpublished order dated December 19, 1991 in which the same court denied Defendant's petition for rehearing *en banc*. That order is reprinted in the appendix hereto beginning at p. A-3. The amended memorandum opinion

of the United States District Court for the Northern District of Ohio, Eastern Division, which is dated December 5, 1990, and which affirmed the turnover order of the bankruptcy court which is the subject of this appeal is not reported, and is reprinted in the appendix hereto at p. A-5. The memorandum of opinion and order of the United States Bankruptcy Court for the Northern District of Ohio, Eastern Division is reported at 111 B.R. 640 (Bankr. N.D. Ohio E.D. March 1, 1990), and is reprinted in the appendix hereto at p. A-1.

## JURISDICTION

1. On October 21, 1991, the United States Court of Appeals for the Sixth Circuit entered its judgment on appeal from the United States District Court for the Northern District of Ohio. [Copy attached, Appendix p. A-3.]

2. On December 19, 1991, the same Court of Appeals, having received a petition for rehearing *en banc,* entered its order denying the petition. [Copy attached, Appendix, p. A-3.]

3. The statutory provision conferring jurisdiction in this Court is 28 U.S.C. 1254(1).

## THE STATUTES AT ISSUE

11 U.S.C. Sec. 541 (1991) [presented in its entirety at the appendix hereto, p. A-15] **Property of the estate**

(a) The commencement of a case under section 301, 302, or 303 of this title [11 U.S.C. Secs. 301, 302, or 303] creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

* * *

(c)(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law -

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title [11 U.S.C. Secs. 101 et seq.], or on the appointment of or taking possession by a trustee in a case under this title [11 U.S.C. Secs. 101 et seq.] or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

(2) A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title [11 U.S.C. Secs. 101 et seq.].

26 U.S.C. Sec. 457 (1991) [presented in its entirety at the appendix hereto, at p. A-18] Deferred compensation; plans of state and local governments and tax-exempt organizations.

* * *

(b) Eligible deferred compensation plan defined.

For purposes of this section, the term "eligible deferred compensation plan" means a plan established and maintained by an eligible employer —

* * *

(6) which provides that —

(A) all amounts of compensation deferred under the plan,

(B) all property and rights purchased with such amounts, and

(C) all income attributable to such amounts, property, or rights,

shall remain (until made available to the participant or other beneficiary) solely the property and rights of the employer (without being restricted to the provision of benefits under the plan), subject only to the claims of the employer's general creditors.

**STATE ADMINISTRATIVE CODE SECTIONS AT ISSUE**

Ohio Administrative Code Sec. 145:1-1-01 (1983) [presented in its entirety in the appendix hereto, at p. A-31] Ohio public employees deferred compensation program

(A) The purpose of this rule is to provide all necessary standards or conditions for the administration of the Ohio public employees deferred compensation program created by sections 145.71 to 145.73 of the Revised Code.

* * *

(C) The board or its designees shall observe the following procedures in implementing and administering the program.

* * *

(6) All plan assets shall be held by the board on behalf of the eligible employer and shall at all times be the assets of the employer and not the assets of the participating employees or the board. To facilitate administration of the program, the board shall create individual participant accounts, bearing the participant's name, but all assets of plans under the program shall be the exclusive property of the employer. * * *

## STATEMENT OF THE CASE

Walter Leadbetter is a firefighter, who in the course of his work for the City of Lorain, Ohio, deferred approximately $3,500.00 of his earnings through a program administered by the Petitioner, the Ohio Public Employees Deferred Compensation Program. In 1989, Mr. Leadbetter filed a petition for relief under Chapter 7 of the Bankruptcy Code, in *In re: Leadbetter,* Case No. B88-01698(B), in the United States Bankruptcy Court for the Eastern Division of the Northern District of Ohio.

During the course of the administration of this debtor's estate in bankruptcy, the trustee filed a motion to have Petitioner turn over to the trustee the debtor's account value. The Petitioner contested the trustee's assertion that funds maintained pursuant to 26 U.S.C. 457 were part of the bankruptcy estate. Upon stipulated facts, the bankruptcy court found funds on deposit with the Plan administered by the Petitioner were voluntarily contributed by the debtor, that the debtor had not claimed an exemption regarding any of the funds[1], that the Plan was promulgated by the Ohio legislature pursuant to congressional authority set forth in 26 U.S.C. 457, and that the debtor had made no withdrawals from the funds since they were deposited. *In re: Leadbetter,* 111 B.R. 640, 641 (Bankr. N.D. Ohio E.D 1990).

Adopting the rationale of *In re: Goff,* 706 F.2d 574 (5th Cir. 1983), as applied in *Daniel v. Security Pacific National Bank,* 771 F.2d 1352 (9th Cir. 1985), *cert. denied,* 475 U.S. 1016 (1986), and cases reported in the Eighth, Ninth, and Eleventh Circuits, the bankruptcy court found that only funds held in state qualified spendthrift trusts would qualify for

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[1] Defendant administers in excess of one billion dollars in deferred compensation for public employees in Ohio; notwithstanding the fact that the debtor did not seek an exemption for his $3,500.00 interest in the fund, the court below found the public interest confers standing upon the defendant to prosecute this appeal, citing *In re: Revco, D.S., Inc.,* 898 F.2d 498 (6th Cir. 1990). *See,* Amended Memorandum Decision, District Court (Dowd, J.), Appendix, p. ***.

exclusion from the bankruptcy estate, rejected the Petitioner's assertions and granted summary judgment in favor of the Trustee, and directed Petitioner to turn over to the Trustee the account value as of the filing of bankruptcy. *In re: Leadbetter, supra,* 111 B.R. at 643. On appeal, the District Court summarily endorsed the rationale and order of the Bankruptcy Court [See, Amended Memorandum Opinion, filed December 5, 1990, at Appendix, p. A-5]. Likewise, the Court of Appeals in a two-paragraph unpublished opinion adopted the rationale offered by the Bankruptcy Court. [See, Per curiam opinion, filed October 21, 1991, at Appendix, p. A-1] After its petition for rehearing *en banc* was denied, the Program filed this Petition.

## JURISDICTIONAL STATEMENT PURSUANT TO S.CT. RULE 14(i).

28 U.S.C. 1334(B) and one or more of the provisions of 28 U.S.C. 157(b)(2): (A), (E), or (O) permit the bankruptcy court to determine the nature of the estate in bankruptcy, and to rule in adversaria. proceedings for the turning over of assets of the estate which are held by third parties.

## ARGUMENT IN SUPPORT OF ALLOWANCE OF THIS WRIT

By adopting the rationale of the Bankruptcy Court below, the Court of Appeals has approved a construction of 11 U.S.C. 541(c)(2) which has been approved by four appellate circuits, rejected by two, and left unresolved in the remaining circuits. The decision leaves unresolved whether anti-alienation provisions of federal and state law by which funds are deferred for retirement will be given effect by the bankruptcy court. Courts, consumers, the bankruptcy bar, and retirement planners nationwide need a consistent and definitive answer as to whether such anti-alienation provisions will be given effect in bankruptcy, and all need to know whether funds deferred for retirement will or will not be subject to the reach of their general creditors in the event the participant seeks relief in bankruptcy.

**Proposition of Law 1: There is a need for national uniformity in the construction of what constitutes "applicable nonbankruptcy law" as that term is used in 11 U.S.C. 541(c)(2).**

In bankruptcy, 11 U.S.C. 541(c)(1) provides that except as otherwise provided the estate in bankruptcy is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." The Bankruptcy Code further provides in Section 541(c)(1)(A) that "an interest of the debtor in property becomes property of the estate . . . notwithstanding any provision . . . that restricts or conditions transfer of such interest by the debtor. . . ." This general rule, however, has an exception, at Section 541(c)(2), which provides, "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title."

The majority of jurisdictions have construed "applicable nonbankruptcy law" to be limited so as not to include any *federal* restrictions, and to include only plans which qualify as state spendthrift trusts. Characteristic of the majority view is the language found in *In re Goff*, 706 F.2d 574 (5th Cir. 1983), which concerned a plan created in conformity with the Employee Retirement Income Security Act (ERISA), 29 U.S.C. Secs. 1001-1144. There, the court stated:

> Although a given state's nonbankruptcy law of spendthrift trusts might afford protection to a particular pension trust, it is clear in the immediate case that appellant's self-settled trust did not constitute a spendthrift trust entitled to exclusion under relevant state law. Id. at 580.

The *Goff* decision was based primarily on three factors: (1) the legislative history of Sec. 541(c)(2); (2) the overall congressional scheme embodied in the Code; and (3) the relationship and effect upon ERISA of the intent of the Code. *Id.*, at 581. Citing these factors, the *Goff* court came to the "inexorable conclusion that Section 541(c)(2)'s reference to

'applicable nonbankruptcy law' was an acknowledgement of traditional state spendthrift law, and not of ERISA." *Id.* Answering a similar question as it concerned a profit sharing retirement plan qualified under 26 U.S.C. 401(a), the court in *In re: Graham,* 726 F.2d 1268, 1273 (8th Cir. 1984) approved the rationale of *Goff,* stating:

> The Fifth Circuit has recently addressed the analogous question of whether self-employed debtors' interests in their tax-qualified Keogh retirement plans are part of the bankruptcy estate. *In re: Goff,* 706 F.2d 574 (5th Cir. 1983). After an examination of the legislative history of Sec. 541(c)(2), the court concluded that Congress intended by its reference to "applicable nonbankruptcy law" to exclude from the estate only those "spendthrift trusts" traditionally beyond the reach of creditors under state trust law. 706 F.2d at 581-82. The retirement plans in *Goff* contained the anti-alienation clause required by the Internal Revenue Code, 26 U.S.C. Sec. 401(a) to qualify for tax benefits. Nevertheless the court held that they were not excluded from the estate under Sec. 541(c)(2) of the Bankruptcy Code.

The court in *Graham* held that the anti-alienation clause in the debtor's retirement plan, which is required by ERISA, 29 U.S.C. Sec. 1056(d)(1), was not "applicable nonbankruptcy law" as that language appears in Sec. 541(c)(2) of the Bankruptcy Code. *Graham, supra,* 726 F.2d at 1271. Upon such finding, the court found the retirement funds to be included in the debtor's estate. *Id.*

Other Courts of Appeal following the majority approach set forth in *Goff* are *Regan v. Ross,* 691 F.2d 81 (2nd Cir. 1982); *In re: Swanson,* 873 F.2d 1121 (8th Cir. 1989); *In re: Daniel,* 771 F.2d 1352 (9th Cir. 1985), *cert. denied,* 475 U.S. 1016, 106 S.Ct. 1199, 89 L.Ed. 313 (1986); and *In re: Lichstrahl,* 750 F.2d 1488 (11th Cir. 1985).

In a minority of appellate court jurisdictions, those persons

who have both been able to save for their retirement and have suffered severe financial setbacks will find protection in the bankruptcy courts: neither they nor the trustee in bankruptcy will have access to these funds, because in these jurisdictions the courts are giving effect to the federal and state restrictions on the transfer of the beneficial interest in these retirement plans. This minority view has only recently been articulated, first by the Fourth Circuit in *In re: Moore,* 907 F.2d 1476 (4th Cir. 1990), then by the Sixth Circuit in *In re: Lucas,* 924 F.2d 597, *cert. denied, sub nom. Forbes v. Holiday Corp. Sav. & Retirement Plan,* 114 L.Ed 2d 726, 111 S.Ct. 2275, 59 U.S.L.W. 3810 (1991). It is also being applied elsewhere in the district and bankruptcy courts in Michigan, Kansas, Texas, and the District of Columbia.[2]

In these minority jurisdictions, the courts have examined various provisions of the Internal Revenue Code, which permit a private or public employer to create income deferment accounts designed for its employees' use upon retirement. These provisions characteristically impose restrictions on the transfer of the beneficial interest in these deferred funds, commonly prohibiting the transfer of deferred funds until the worker reaches retirement age, or separates from service, or suffers an unforeseeable financial emergency justifying access to the funds. In Mr. Leadbetter's case, the plan was a voluntary deferred compensation program created pursuant to 26 U.S.C. 457; in *Moore,* the debtor contributed to a retirement and profit-sharing plan

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[2] See, e.g., *In re: Idalski,* 123 B.R. 222, 234 (Bkrtcy. E.D. Mich. S.D. 1991), *In re: Threewitt,* 24 B.R. 927, 930 (D. Kan. 1982), *In re: Cheaver,* 121 B.R. 665 (Bkrtcy. D. D.C. 1990), *In re: Majul,* 119 B.R. 118, 124 (Bkrtcy. W.D. Texas S.A. 1990), *In re: Ralston,* 61 B.R. 502, 504-05 (Bkrtcy. D. Kan. 1986). For decisions prior to the *Moore* decision which rejected the rationale found in *Goff,* see, *In re: Mosley,* 42 B.R. 181, 191 (Bkrtcy. D. N.J. 1984), *Warren v. G.M. Scott & Sons,* 34 B.R. 543, 544 (Bkrtcy. S.D. Ohio, 1983), *In re: Holt,* 332 B.R. 767, 772 (Bkrtcy. E.D. Tenn. 1983), *In re: Pruitt,* 30 B.R. 330, 331 (Bkrtcy. D. Colo. 1983), *In re: Rogers,* 24 B.R. 181, 183 (Bkrtcy. D. Ariz. 1982); *see also, In re: Leamon,* 121 B.R. 974 (Bkrtcy. E.D. Tenn. 1990) (governmental plan not subject to title I of ERISA, but containing the anti-alienation provision mandated by 26 U.S.C. 401(a)(13)).

qualified pursuant to ERISA. In both cases provisions of the Internal Revenue Code require the establishment of restraints on the transfer of the beneficial interest of these funds: 26 U.S.C. 401(a)(13) of the Internal Revenue Code requires that in order for an ERISA pension plan to receive tax-exempt status, it must provide that benefits under the plan may not be assigned or alienated. *See also* Tres. Reg. Sec. 1.403(a)-13(b)(1).

Under 29 U.S.C. 1056(d)(1), in all ERISA plans all encroachments, both voluntary and involuntary, are prohibited. *General Motors v. Buha,* 623 F.2d 455, 460 (6th Cir. 1980). Encroachments are likewise prohibited in plans under 26 U.S.C. 457, which expressly provides that the deferred property and rights "shall remain (until made available to the participant or other beneficiary) solely the property and rights of the employer (without being restricted to the provision of benefits under the plan), subject only to the claims of the employer's general creditors." 26 U.S.C. 457(b)(6).

It is the inconsistent adherence by bankruptcy courts to these restraints upon the transfer of a debtor's beneficial interest which merits this Court's attention. With the Fourth and Sixth Circuits giving effect to the plain meaning of Sec. 541(c)(2), and the Second, Fifth, Eighth, Ninth, and Eleventh Circuits rejecting the plain language and relying instead on legislative history in applying the section, there is a well-defined split among appellate circuits, one warranting this Court's review.

Petitioner acknowledges that because contributions to a Sec. 457 plan are voluntary, such a plan would be ineligible under most common law theories to be considered a spendthrift trust. No Ohio statute explicitly establishes the validity of spendthrift trusts, and the Ohio Supreme Court has said, in the only case dealing directly with the question, that an owner of property should not, without legislative authority, be permitted, by setting up a spendthrift trust, to exempt either property or income therefrom from the claims of the creditors of a beneficiary of the trust. *Sherrow v.*

*Brookover,* 174 O.S. 310, 189 N.E.2d 90 (1963); 91 O.Jur.2d Trusts, Sec. 193.

The bankruptcy court, however, focused not on state law, but on the interpretation of Sec. 541(c)(2) of the Bankruptcy Code, and determined that the only means for excluding the funds from the debtor's estate would be if the Petitioner's plan constituted a state spendthrift trust. This decision, drawing as it does exclusively from the rationale found in *Goff* and *Daniels,* is directly at odds with *Moore* and *Lucas.*

The practical effect of this conflict among the circuits is to leave the country divided as to whether a worker's retirement savings will survive the worker's bankruptcy. The school nurse who consults a bankruptcy attorney in Augusta, Georgia will find her attorney relying on the Eleventh Circuit's decision in *In re: Lichstrahl, supra,* and will be told that if she declares bankruptcy her deferred savings will be lost to pay creditors; whereas the police officer who asks the same question sixteen miles away in Aiken, South Carolina will be told, according to the Fourth Circuit's decision in *In re: Moore, supra,* that the funds will remain beyond the reach of her creditors in bankruptcy. Hardest of all are questions posed by debtors in states in the Sixth Circuit, which cannot seem to make up its mind (the present case demonstrates the point)[3], and states in the First, Third, and Seventh Circuits, and the District of Columbia Circuit, which have not yet passed on the question at the circuit level.

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[3] As discussed *infra,* the Sixth Circuit has in *In re: Lucas, supra,* expressly joined with the Fourth Circuit in *rejecting* the construction of "applicable nonbankruptcy law" offered by the Courts in *Daniel, Lichstrahl,* and *Graham;* yet these are the same cases relied upon by the bankruptcy court below when it construed "applicable nonbankruptcy law" to mean only state spendthrift trusts. At the time it did so, however, the bankruptcy court did not have the benefit of *Lucas;* this does not explain, however, why the Court of Appeals in this case did not attempt to clarify its position when this matter was presented to it for review, by which time *Lucas* had been decided.

Likewise in question is the practice of those who would encourage workers to save: those who offer deferred compensation plans are told by the Internal Revenue Service that these plans must shield the funds from attachment, assignment, and garnishment, and from this the plan marketers commonly represent that these funds are protected from such invasion by the employee's creditors and by the trustees in bankruptcy. These representations, entirely valid given the mandate of the IRS, will be subject to question if the trustees in bankruptcy are permitted access to the funds in the course of a consumer's bankruptcy. The representations are being honored in the Fourth Circuit and in many of the districts where the courts of appeals have not yet decided the matter. They are being breached in those following the *Goff* view. Only by the intervention of the Supreme Court may these irreconcilable positions be aligned.

**Proposition of Law 2: The bankruptcy court should give effect to federal and state laws which restrict the transfer of the beneficial interest of funds held in accounts created to ensure the availability of such funds for the contributor's retirement.**

The bankruptcy court below had before it both federal and state law which created a "restraint on the transfer of a beneficial interest" of the debtor. 26 U.S.C. 457(b)(6) requires that any plan for deferring compensation under that code section shall provide that "(A) all amounts of compensation deferred under the plan, (B) all property and rights purchased with such amounts, and (C) all income attributable to such amounts, property, or rights *shall remain* (until made available to the participant or other beneficiary) *solely the property and rights of the employer* (without being restricted to the provision of benefits under the plan), subject only to the claims of the employer's general creditors." (Emphasis added.)

Under this law, the "property and rights" contributed by the employee are not the employee's, but are the "property and rights" of the employer.

State law, too, echoed these provisions, at Ohio Administrative Code Section 145:1-1-01(C)(6), which provides:

> All plan assets *shall be held by the board on behalf of the eligible employer and shall at all times be the assets of the employer and not the assets of the participating employees or the board.* To facilitate administration of the program, the board shall create individual participant accounts, bearing the participant's name, but *all assets of plans under the program shall be the exclusive property of the employer.* The board shall issue to the participating employees, on behalf of the employer, at least annually, a statement of account values, setting forth the value of a participating employee's account as of such date. All information regarding a participant's account shall be confidential. [Emphasis added.]

In order to direct the turnover of funds to the trustee, the bankruptcy court had to disregard these provisions of law, and did so by making reference to 11 U.S.C. Sec. 541(a)(1), which includes as "property of the estate" all legal or equitable interests of the debtor in property as of the commencement of the case. 111 B.R. at 642. Having determined the debtor's "inchoate interest in the deferred funds" to be estate property under Sec. 541(a)(1), the court then referred to Sec. 541(c)(2) of the Bankruptcy Code.

> Section 541(c)(2), as noted above, provides an exclusion from estate property where the debtor's beneficial interest in a trust is enforceable under applicable nonbankruptcy law. The phrase "applicable nonbankruptcy law," however, has been interpreted narrowly as a reference to state spendthrift law which is not applicable to the present matter. See, *Kaplan v. Primerit Bank,* 97 B.R. 572 (Bankr. 9th Cir. 1989), *Daniel v. Security Pacific National Bank,* 771 F.2d 1352 (9th Cir. 1985); *cert. denied,* 457 U.S. 1016, 106 S.Ct. 1199, 89

L.Ed.2d 313 (1986), *Lichstrahl v. Bankers Trust*, 750 F.2d 1488 (11th Cir. 1985), and *In re: Graham*, 726 F.2d 1268 (8th Cir. 1984). 111 B.R. at 642.

Each of the cited cases construe "applicable nonbankruptcy law" as requiring the bankruptcy court to recognize only those restraints on the transfer of a debtor's beneficial interest where there is a "state spendthrift trust" established. Each of the cited cases in turn rely upon the construction of "applicable nonbankruptcy law" which appears in *In re: Goff*, 706 F.2d 574 (5th Cir. 1983).[4] By relying on this rationale, the bankruptcy court below refused to give effect to the state and federal laws which restrict the debtor's access to these deferred funds, finding that the restrictions did not create a "state spendthrift trust." *In re: Leadbetter*, 111 B.R. at 644.

In turn, the district court "affirms the turn over order for the reasons set forth by Bankruptcy Judge Randolph Baxter in this opinion and order of March 1, 1990." [Amended memorandum decision of Dowd, J., Appendix, p. A-5.] In similar summary fashion, the Court of Appeals found no error on the part of the district court and "[f]or the reasons stated by the bankruptcy court in its opinion of March 1, 1990, and adopted by the district court in its opinion of November 30, 1990, as amended on December 5, 1990, we agree that the deferred funds are the property of the bankruptcy estate." [Per Curiam Opinion, October 21, 1991, Appendix, p. A-1.]

By its approval of the rationale found first in *Goff*, the Court of Appeals vitiates the provisions of state and federal law which requires that a deferred compensation plan member have no property interest or right in his deferred compensation account. This rationale in turn deprives the plan member of the ability to preserve these funds for the member's retirement, and permits the trustee in bankruptcy to gain access to funds which neither the plan participant

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[4] *Kaplan, supra*, 97 B.R. at 576; *Daniel, supra*, 771 F.2d at 1359, *Lichstrahl, supra*, 750 F.2d at 1491, and *Graham, supra*, 726 F.2d at 1273.

nor the participant's creditors would otherwise have access to, all in derogation of the legislative plan that these funds be held separate from the reach of the participant and the participant's creditors.

The view taken by *Goff* and rejected in *Moore* is that only funds which qualify as state spendthrift trusts are excluded from the bankruptcy estate. 11 U.S.C. 541(c)(2) does not expressly speak to state spendthrift trusts, but instead provides "[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law" is enforceable in bankruptcy proceedings. By limiting such enforcement to state spendthrift trusts, however, courts following *Goff* have taken a wide array of retirement funds from debtors.

The *Goff* construction led the Second Circuit to disregard a New York state pension provision found at N.Y. Retire. & Soc. Sec. Law Sec. 110(2),(3) (McKinney 1971), which provides that state pension benefits "[s]hall not be subject to execution, garnishment, attachment or any other process whatsoever" and that such benefits "[s]hall be unassignable. . . ." *Regan v. Ross*, 691 F.2d 81, 83 (2nd Cir. 1982). The construction also has been used to circumvent the anti-alienation provisions of 29 U.S.C. Sec. 1056(d)(1) [ERISA], which states that "[e]ach pension plan shall provide that benefits provided under the plan shall not be assigned or alienated;" and 26 U.S.C. Sec. 401(a)(13) [Internal Revenue Code], which provides that "[a] trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that benefits provided under the plan may not be assigned or alienated." *In re: Daniel, supra,* 771 F.2d at 1358-59. The construction defeated provisions in the Teachers Retirement Association created by the State of Minnesota, which (at M.S.A. Sec. 354.10) provided "[A]ll moneys to the credit of a teacher's account in the fund . . . shall belong to the state of Minnesota until actually paid to the teacher . . . ." *In re: Swanson,* 873 F.2d 1121, 1123 (8th Cir. 1989).

As it was in these cases, so it is now with the Petitioner's case: acting to conform to the statutory expression found in 26 U.S.C. 457, the State of Ohio enacted provisions of law by which its public employees could commit present earnings for use upon retirement. 26 U.S.C. 457(b)(6) directs that in order to qualify for tax deferred status, the state's plan must provide that the funds on deposit remain "solely the property and rights of the employer" which in this case is the City of Lorain, Ohio. The effect of the decision of the court below is to abrogate the express statutory provision found at 26 U.S.C. 457(b)(6) and the administrative regulation carrying out that provision which is found at Ohio Administrative Code Sec. 145:1-1-01(C)(6). The *Goff* construction thus is leading to the dismantling of those various state and federal anti-alienation provisions whose purpose is the preservation of funds for the contributor's retirement.

In early cases in jurisdictions which have narrowly construed Sec. 541(c)(2), the facts commonly were that the attempts to exclude property from the reach of the bankruptcy estate were made by a corporation controlled by the debtor. *See, Daniel,* 771 F.2d at 1353 (plan established by professional corporation of which debtor was "sole director and shareholder"); *Lichstrahl,* 750 F.2d at 1489 (same); *Graham,* 726 F.2d at 1269 (same). As the bankruptcy court in a recent Michigan case recently observed, a motivating factor behind the interpretation given to Sec. 541(c)(2) may have been the desire to avoid what the courts perceived to be an unjust result. *In re: Idalski,* 123 B.R. 222 (Bankr. E.D. Mich. 1991). In *Idalski,* the court notes the irony of this result as it rejects the narrow construction found in *Goff,* where it states that "the perceived injustice—the establishment of creditor-proof self settled spendthrift trusts—is clearly permissible as long as the plan complies with the requirements specified in ERISA." 123 B.R. at 233.

If given effect, the provisions of 26 U.S.C. 457 would prohibit, even in bankruptcy, both the debtor and the debtor's creditors from transferring the beneficial interest in the funds maintained by the Petitioner. Sec. 457(d)(1)(A)(i)-(iii) provides

limits to the distribution of deferred funds held by Petitioner, requiring that such a distribution will not be made available to participants or beneficiaries earlier than (i) the calendar year in which the participant attains age 70 1/2, (ii) when the participant is separated from service with the employer, or (iii) when the participant is faced with an unforeseeable emergency (determined in the manner prescribed by the Secretary in regulations). The debtor in this case has not attained age 70 1/2, is still a employed with the City of Lorain, and made no request for a determination that he was faced with an unforeseeable emergency.[5]

When the employee suffers a *foreseeable* financial distress (such as is occasioned by improvident use of credit cards and the like), the funds deferred are generally not available; again, the purpose is to meet the employee's need at retirement, and accordingly the IRS provisions require that such plans have express prohibitions against attachment or assignment of these funds, and against the transfer of the beneficial interest outside of the parameters set by the applicable code provision. These funds likewise remain

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[5] "Unforeseeable emergency" is defined at Sec. 1.457.2(h)(4) [Para. 2899JJ, CCH 1988]:

> For the purposes of this paragraph (h), an unforeseeable emergency is, and if the plan provides for payment in the case of an unforeseeable emergency must be defined in the plan as, severe financial hardship to the participant resulting from a sudden and unexpected illness or accident of the participant or of a dependent (as defined in section 152(a)) of the participant, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstance arising as a result of events beyond the control of the participant. The circumstances that will constitute an unforeseeable emergency will depend upon the facts of each case, but, in any case, payment may not be made to the extent that such hardship is or may be relieved (i) Through reimbursement or compensation or otherwise, (ii) By liquidation of the participant's assets, to the extent the liquidation of such assets would not itself cause severe financial hardship, or (iii) by cessation of deferrals under the plan.

beyond the reach of the employee's general creditors, who might otherwise seek to garnish or attach the funds.

In the context of ERISA and Keogh plans, *Moore*, *Lucas*, and lower court jurisdictions rejecting the approach taken in *Goff* have considered these restrictions on the transfer of beneficial interest favorably to the debtor, when the trustee in bankruptcy has sought to invade these savings plans. The same approach, if taken with accounts maintained pursuant to Sec. 457 of the Internal Revenue Code, will permit the deferred funds to remain intact until the time of the debtor's retirement.

**Proposition of Law 3: By adopting a construction of 11 U.S.C. 541(c)(2) so as limit the meaning of "applicable nonbankruptcy law" to include only state spendthrift trusts, the Court of Appeals failed to give effect to the words appearing in the statute, and resorted unnecessarily and improperly to legislative history and other devices of statutory construction to reach a result contrary to the plain language of the statute.**

Those courts which have adopted *Goff*, including the bankruptcy court and Court of Appeals in *Leadbetter*, have taken a plainly written section of the Code, which directs the bankruptcy court to respect "applicable nonbankruptcy law" when determining whether to enforce restrictions on the transfer of funds held in behalf of a debtor, and imposed upon it a wholly different meaning. According to the narrow view approved in *Goff* and *Daniel*, Congress intended those words to mean "state spendthrift trust," and also intended to *exclude* all federal law which might also have constituted "nonbankruptcy law" whose import was to restrict the transfer of the beneficial interest in funds held by a third party retirement plan in behalf of a debtor.

Of the cases applying this restrictive view of Section 541(c)(2), the opinion in *Goff* goes into greatest detail on the question. There, the court reviews the legislative history of Section 541(c)(2), beginning by observing "The legislative

history of Section 541(c)(2) indicates that Congress had something very specific in mind with its facially broad reference to 'applicable nonbankruptcy law' as the benchmark for assessing the enforceability of trust restraints on alienation in bankruptcy." 706 F.2d at 581. According to *Goff*, the "facially broad" language in the statute, refers only to something "very specific," based on the legislative history of the section.

The court in *Goff* examines both the House and Senate Report, finding both state the section "preserves restrictions on a transfer of a spendthrift trust." It also notes that its construction of the section would be consistent with the text of the prior section: "from the legislative history of Section 541(c)(2), it is clear that Congress intended by its reference to 'applicable nonbankruptcy law' to exempt from the estate only those "spendthrift trusts" traditionally beyond the reach of creditors under state law. This provision carries over from the old Act the previously recognized exemption for spendthrift trusts." 706 F.2d at 582.

From *Goff* and *Daniel*, where the debtors were able to control their contributions to these essentially self-settled trusts (see *Goff*, 706 F.2d at 589, and *Daniel*, 771 F.2d 1353), the courts in accord with *Goff* have extended this rationale, so that the trustee's reach now includes even the mandatory employee and employer contributions paid into a teachers retirement fund. *See, In re: Swanson*, 873 F.2d 1121 (8th Cir. 1989). The bankruptcy court's disregard for the anti-alienation provisions of state and federal law has now far exceeded that which began as an attempt to "do equity" for creditors who were frustrated by the acts of sole shareholders of corporations who may have unscrupulously attempted to shield their beneficial interest in their corporations by the use of "retirement" plans. By applying the *Goff* construction as in *Swanson*, the courts are abrogating a congressional plan which has permitted millions of working class Americans to save for their old age. As the bankruptcy court observed in *In re Idalski*, *Goff*, *Daniel*, *Lichstrahl*, and *Graham*, all were cases where sole directors and shareholders established their Keogh or ERISA

plans, all of which would have frustrated the corporate creditors. These cases, according to the court in *Idalski* as it explains its rationale for rejecting *Goff*, "provide a vivid example of the adage that 'hard cases make bad law." ' 123 B.R. at 234.

If the narrow construction of "applicable nonbankruptcy law" in *Goff, Daniel, Lichstrahl,* and *Graham* arose out of a sense that retirement plans should not be the refuge of the sole corporate director and shareholder who would unfairly frustrate his creditors, then other analyses are available to the court, analyses which do not require such a strained reliance on legislative history to achieve an equitable result.

Trusts which have as their purpose delaying, hindering, or defrauding creditors are common examples of trusts with illegal purposes. A creditor who has been adversely affected by a trust which was created for the purpose of hindering or preventing the collection of his claim can maintain a suit to have the trust set aside and the subject matter be made available for the satisfaction of his judgment. *See, e.g., Barker v. Dunham* 342 P.2d 867, 9 Utah 2d 244 (1959) (where a trust is created for the purpose of preventing creditors from collecting claims, a trustee in bankruptcy of the debtor may bring an action to set aside the deed); *see also,* Bogert, *The Law of Trusts and Trustees,* Rev. 2nd Ed. (1979), Sec. 211.

In this same fashion, the trustee in bankruptcy may, pursuant to Sec. 548 of the Bankruptcy Code, "avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor" where the debtor, among other provisions, "made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted." The perceived inequity of granting to the sole shareholder and corporate officer the benefit of transferring funds into an ERISA-qualified plan addresses just this point, yet in none of the cases following *Goff* and

relied upon by the bankruptcy court below do the trustees attempt to avoid the transfer as fraudulent, but rather they look to the legislative history of Section 541(c)(2) as a more expeditious means at correcting the perceived wrong. The long-term benefit of encouraging workers to save for their retirement inures to millions of Americans, and should not be diminished in the interest of prosecuting debtors in those instances where the trustee perceives a deliberate intent to defraud creditors.

In rejecting *Goff*, the Fourth Circuit in *In re: Moore, supra*, finds first that "[a]n appeal to legislative history is inappropriate here because the language of Sec. 541(c)(2) is clear." 907 F.2d at 1478. It expressly rejected *Goff's* reliance on legislative reports, stating "[w]e have no authority to limit the scope of a clear statutory term by recourse to the views of a legislative subgroup." *Id.*, at 1479, citing *Davis v. Michigan Dep't. of Treasury*, 489 U.S. 803, 109 S.Ct. 1500, 1504 n. 3, 103 L.Ed. 2d 891 (1989). Even if resort is made to legislative history, the Court in *Moore* finds "[a]t most, these passages suggest that Congress intended state spendthrift trust law to be included within the meaning of 'applicable nonbankruptcy law.' "

The approach taken by the court in *Moore* calls for the bankruptcy court to determine if anti-alienation provisions found in federal or state law are enforceable against general creditors. If they are, then Sec. 541(c)(2) makes the provisions also enforceable against the bankruptcy trustee. 907 F.2d at 1480. The benefit of this analysis is threefold:

(1) It gives effect to the language of both the Bankruptcy Code and to the provision in Title 26 controlling retirement plans (such as those created under ERISA and those created under 26 U.S.C. 457), by "ensuring that the security of employee retirement benefits will not depend on the particularities of state spendthrift laws." 907 F.2d at 1480.

(2) By providing that funds deferred in a Sec. 457 plan remain the property of the employer, Congress erected a barrier to both the employee and his or her general creditors,

and this approach gives effect to that barrier, whereas *Goff* rends the barrier (but only for trustees in bankruptcy). In practical terms, *Goff* permits the general creditor to force a liquidation of these retirement funds. As the court in *Moore* observed: "Appellant's position would provide creditors with a means to circumvent this restriction on their access. We see no evidence that Congress intended to invite a creditor to push a debtor into involuntary bankruptcy in order to reach his ERISA funds." 907 F.2d at 1480. The same is true with Sec. 457 funds, which except in bankruptcy (according to *Leadbetter*) expressly remain "solely the property and rights of the employer" and not the employee during the time of deferment. 26 U.S.C. 457(b)(6).

(3) The approach taken by *Moore* "avoids the specter of a bankruptcy trustee disqualifying an entire plan from tax exempt status by seeking turnover of a single bankrupt's interest in the plan." *Id.* Like ERISA plans, the continued tax deferred status of plans under Section 457 depend on compliance with the anti-assignment provisions of 26 U.S.C. 457(b)(5) and (6). It is true that were the plan to be out of compliance with Sec. 457, it is permitted 180 days to effect the changes to bring about its compliance. 26 U.S.C. 457(b)(6). However, if the result of the decision of the Court of Appeals below is to abrogate the requirement that funds deferred remain "solely the property and rights of the employer" then there would appear to be no way the plan administrators could bring the program into compliance. Given that there are over one billion dollars invested in this fund, the tax consequences of the loss of such a tax deferred status alone would be substantial and of national significance.

The confusion created by this split of opinions is best exemplified by the proceedings below. Eight months after the Bankruptcy Court entered its judgment in this case, adopting the *Goff* view on this issue, the Sixth Circuit expressly rejected *Goff* and approved the rationale in *Moore*. *In In re: Lucas, supra,* the Sixth Circuit was persuaded that the majority's "narrow interpretation of the statute, in addition to violating the plain language of Sec. 541(c)(2), is also inconsistent with other uses of the identical phrase

throughout the Bankruptcy Code, where the phrase is used to refer to the federal as well as state law." 924 F.2d at 601. Examples given included the use of the phrase "applicable nonbankruptcy law" in 11 U.S.C. 1125(d), which includes, *inter alia*, federal securities law. *See, In re: Stanley Hotel, Inc.* 13 B.R. 926, 931 (Bankr. D.Colo. 1981), and 11 U.S.C. 108(a), which extends the time in which a trustee can pursue a cause of action which the debtor could have pursued in accordance with the tolling provisions of "applicable nonbankruptcy law" which includes, *inter alia*, the Racketeer Influenced and Corrupt Organizations Act. *See, In re: Ahead By a Length, Inc.*, 100 B.R. 157, 162-63 (Bankr. S.D. N.Y. 1989).

When presented with the bankruptcy petition of Elizabeth Hayes Lucas, who had saved $2,000.00 in a retirement account with her employer, and the trustee's motion for turnover (which the bankruptcy court had permitted), the Sixth Circuit in *Lucas* examined the rationale in *Moore* and found it to be persuasive. The court acknowledged the problems which *Goff* created, and found, as did the court in *Moore*, that the better approach (1) harmonizes the Bankruptcy Code with the Internal Revenue Code and ERISA and gives full effect to the express language of those statutes; (2) prevents a plan from being disqualified and losing its tax-exempt status when a trustee in bankruptcy seeks a turnover of a single debtor's interest in a plan, and (3) guarantees uniform treatment of benefits throughout the country. 924 F.2d at 603.

Six months after *Lucas* was reported, the same court, with one of the same panel members participating, had before it the appeal in *Leadbetter.* The court below, in *In re: Leadbetter,* 111 B.R. 640 (Bkrtcy. N.D. Ohio E.D., 1990) had to determine first whether the debtor's deferred compensation is an asset of the estate, 111 B.R. at 641, and second whether "any provision of the Bankruptcy Code excludes that property from recovery by the Trustee." 111 B.R. at 642. Again going through an analysis of the legislative history of Section 541(c)(2), the Bankruptcy Court concluded "the phrase 'applicable nonbankruptcy law' has been interpreted narrowly as a reference to state spendthrift trust

law which is not applicable to the present matter." (Citing *Kaplan v. Primerit Bank,* 97 B.R. 572 (Bankr. 9th Cir. 1989); *Daniel, supra; Lichstrahl, supra;* and *Graham, supra.*

Despite the fact that the Sixth Circuit had in *Lucas* already expressly rejected the narrow construction relied upon by the Bankruptcy Court, it approved (without explanation) the Bankruptcy Court's embrace of *Daniels,* et al. Thus, for six months practitioners in Ohio could safely have advised their bankruptcy clients that *Lucas* could be relied upon to protect their retirement funds in the event of a bankruptcy, but after the Court of Appeals issued its decision in *Leadbetter* approving the Bankruptcy Court's analysis, the matter once again is unresolved. The bankruptcy bar's hope that this Court would have resolved the issue was raised by the application for a writ of certiorari in *Lucas,* but that too was unsuccessful. *In re Lucas,* 924 F.2d 297 (6th Cir. 1991), *cert. denied, sub nom. Forbes v. Holiday Corp. Sav. & Retirement Plan,* 111 S.Ct. 2275, 114 L.Ed. 2d 726, 59 U.S.L.W. 3810 (1991) (J. White and O'Connor would grant certiorari.)

The conflict within circuits is not, however, limited to the Sixth Circuit. In the Fifth Appellate Circuit, where *In re: Goff, supra,* set the standard for the majority view, at least one bankruptcy court found the rationale of *Moore* to be the more persuasive one.

> The premise that "applicable nonbankruptcy law" refers only to state spendthrift trust law rather than ERISA, supported chiefly by the citation to legislative history, was the entire foundation for the holding in *Goff* that a qualified pension plan is property of the estate if it is a self-settled trust under state law. Although *Goff* contained a careful analysis construed on that premise, this Court disagrees with that basic premise and believes that in light of subsequent opinions by the United States Supreme Court, the Court of Appeals for the Fourth Circuit, and district and bankruptcy courts, the premise is incorrect and undermines the force of the *Goff* holding. *In re: Majul,* 119 B.R. 118, 120

(Bankr. W.D. Texas, 1990).

The court in *Majul* recognized the nationwide danger which flows from the rationale and result of *Goff:* that legislation aimed at guaranteeing the security of retirement income for American workers is eroding through this exception to the anti-alienation policy of retirement plans like those permitted by ERISA.

Of importance to the court in *Majul* was this Court's recent treatment of spendthrift provisions in ERISA pension plans in *Guidry v. Sheetmetal Workers Nat'l. Pension Fund,* 493 U.S. 365, 110 S.Ct. 680, 107 L.Ed.2d 782 (1990). In *Guidry,* this Court decided that the trustee of a labor union pension plan, who admittedly had embezzled funds from his labor union, was still protected by the ERISA prohibition against the assignment or alienation of pension benefits. "[ERISA] Section 206(d) reflects a considered congressional policy choice, a decision to safeguard a stream of income for pensioners (and their dependents, who may be, and perhaps usually are, blameless), even if that decision prevents others from securing relief for the wrongs done to them. If exceptions to this policy are to be made, it is for Congress to make them." 493 U.S. at 376, 110 S.Ct. at 795.

The policy protecting sheetmetal workers' funds in ERISA exist likewise in plans under Section 457, where the funds deferred are by express language maintained as the property of the employer, and not of the employee. As the court stated in *Majul,* it seems "incongruous that an imprisoned embezzler in *Guidry* received protection of his pension plan benefits, while an innocent but insolvent debtor in bankruptcy would not receive the ERISA anti-alienation protection." This Court recognized and enforced ERISA's anti-alienation provisions in *Guidry,* and in the same sense the intervention of this Court is once again required.

## CONCLUSION

The petitioner urges this Court to grant its petition for a writ of certiorari so that it may review the important statutory construction issues raised in this case.

Respectfully submitted,

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**Counsel of Record for Petitioner**

**APPENDIX**

IN RE WALTER C. LEADBETTER, Debtor,

MARVIN A. SICHERMAN, Appellee, v. OHIO PUBLIC EMPLOYEES DEFERRED COMPENSATION PROGRAM, Appellant

No. 91-3076

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

1991 U.S. App. LEXIS 25127

October 21, 1991, Filed

NOTICE: [*1] NOT RECOMMENDED FOR FULL-TEXT PUBLICATION. SIXTH CIRCUIT RULE 24 LIMITS CITATION TO SPECIFIC SITUATIONS. PLEASE SEE RULE 24 BEFORE CITING IN A PROCEEDING IN A COURT IN THE SIXTH CIRCUIT. IF CITED, A COPY MUST BE SERVED ON OTHER PARTIES AND THE COURT. THIS NOTICE IS TO BE PROMINENTLY DISPLAYED IF THIS DECISION IS REPRODUCED.

SUBSEQUENT HISTORY: Reported as Table Case at 946 F.2d 895, 1991 U.S. App. LEXIS 29051.

PRIOR HISTORY: On Appeal from the United States District Court for the Northern District of Ohio; District No. 90-00731; Dowd, Jr., District Judge.

JUDGES: Milburn and Suhrheinrich, Circuit Judges, and Leon Jordan, District Judge*. * The Honorable Leon Jordan, United States District Judge for the Eastern District of Tennessee sitting by designation.

PER CURIAM OPINION: Defendant Ohio Public Employees Deferred Compensation System ("the Ohio Program") appeals from the district court's decision enforcing a turnover

order issued on March 1, 1990 by the United States Bankruptcy Court for the Northern District of Ohio. The bankruptcy court ordered the debtor, Walter C. Leadbetter, to turn over to the trustee certain funds deferred by the debtor under the Ohio Program. The United States District Court for the Northern District of Ohio affirmed the bankruptcy court's order. This appeal followed.

Having carefully considered the arguments of counsel, and the briefs and joint appendix filed by the parties, we are unable to say that the district court erred in ordering the deferred funds to be included in the bankruptcy estate. The Ohio Program fears that it might lose its tax exempt status under 26 U.S.C. @ 457. We see no merit in this claim. Appellant also argues that pursuant to 26 U.S.C. @ 457 the deferred funds are not the property of the debtor. This provision merely establishes that the debtor has no taxable interest in the deferred funds. It does not indicate whether he has a property interest for the purposes of the bankruptcy code. Thus, we find no tension between the tax code, 26 U.S.C. @ 457, and the bankruptcy code, 11 U.S.C. @ 541(a)(1). For the reasons stated by the bankruptcy court in its opinion of March 1, 1990, and adopted by the district court in its opinion of November 30, 1990, as amended on December 5, 1990, we agree that the deferred funds are the property of the bankruptcy estate.

We therefore AFFIRM the order of the district court.

**No. 91-3076**

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

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| IN RE: WALTER C. LEADBETTER, | ) | |
| | ) | |
| Debtor | ) | |
| | ) | |
| _____ | ) | |
| MARVIN A. SICHERMAN, TRUSTEE, | ) | |
| | ) | |
| Plaintiff-Appellee, | ) | |
| | ) | |
| v. | ) | ORDER |
| | ) | |
| THE OHIO PUBLIC EMPLOYEES DEFERRED COMPENSATION PROGRAM, | ) | |
| | ) | |
| Defendant-Appellant. | ) | |

BEFORE: MILBURN and SUHRHEINRICH, Circuit Judges; and JORDAN,* United States District Judge

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original hearing panel.

The panel has further reviewed the petition for rehearing and concluded that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

*Hon. Leon Jordan sitting by designation from the Eastern District of Tennessee.

ENTERED BY ORDER OF THE COURT

Leonard Green, Clerk

Filed December 19, 1991.

DOWD, J.

**UNITED STATES DISTRICT COURT**
**NORTHERN DISTRICT OF OHIO**
**EASTERN DIVISION**

| | | |
|---|---|---|
| In Re: Walter C. Leadbetter | ) | CASE NO. 1:90 CV 0731 |
| | ) | |
| Debtor, | ) | APPEAL-BANKRUPTCY COURT |
| | ) | B88-1698 |
| | ) | |
| | ) | AMENDED MEMORANDUM OPINION |

On May 11, 1988, the debtor, Walter C. Leadbetter, filed a Chapter 7 bankruptcy action. This case arises from an appeal taken by the appellant Ohio Public Employees Deferred Compensation Program ("Ohio Program") to the order of the bankruptcy court to the Ohio Program to turn over approximately $3,500.00 to the Chapter 7 debtor's estate. According to the Ohio Program, the sole issue on appeal is:

> Whether the Bankrupcty Court erred in its Judgment that amounts deferred under a plan administered in accordance with 26 U.S.C. §457 are an asset of the debtor's estate, and are subject to an order that the amounts be distributed to the trustee in bankruptcy.

The Trustee raises the additional issue of the Ohio Program's standing to prosecute an appeal of the bankruptcy court's order.

The Court finds that the public interest confers standing upon the State of Ohio to prosecute the appeal in this case. See *In re Revco, D.S. Inc.*, 898 F.2d 498 (6th Cir. 1990).

After considering the briefs of the parties, oral argument and the supplemental briefs filed after oral argument, the

Court affirms the turn over order for the reasons set forth by Bankruptcy Judge Randolph Baxter in his opinion and order of March 1, 1990.

IT IS SO ORDERED.

David D. Dowd, Jr.
U.S. District Judge

In re: WALTER C. LEADBETTER, Debtor
Case No. B88-01698 Chapter 7

UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF OHIO, EASTERN DIVISION

111 Bankr. 640; 1990 Bankr. LEXIS 475; 12 E.B.C. 1217

March 1, 1990

COUNSEL: Marvin A. Sicherman, Esq., Panel Trustee, Cleveland, Ohio. James J. Barrow, Esq., Atty. for Trustee, Cleveland, Ohio. Gerald Krainess, Esq., Atty. for debtor, Cleveland, Ohio. Shawn H. Nau, Assistant Attorney General, Chief Counsel's Staff, Columbus, Ohio. Office of U. S. Trustee, Cleveland, Ohio.

In Proceedings Under Chapter 7

MEMORANDUM OF OPINION AND ORDER BAXTER, U.S.B.J.

This matter came on for hearing upon the motion of the case trustee seeking a turnover of certain funds held in a deferred compensation plan. The following constitutes the Court's findings and conclusions.

Following the Debtor's filing of a voluntary petition for relief under Chapter 7, the case trustee discovered wages in excess of $ 3,500.00 (The Funds) were deferred by the Debtor under the Ohio Public Employees Deferred Compensation Program (The Plan) prior to the bankruptcy filing. Noting that the Debtor had not claimed any exemption respecting the funds, the present motion was filed by the trustee to effect a remittance of the amounts voluntarily contributed by the Debtor to The Plan. Although no objection was filed by the Debtor, the State of Ohio, through its Attorney General, has objected to the turnover of funds. For the reasons set forth herein, the subject funds are determined to be property of the Debtor's estate pursuant to 11 U.S.C. 541, and the turnover of same is hereby ordered.

I.

The undisputed facts reveal that The Funds on deposit in The Plan were voluntarily contributed by the Debtor. The Debtor has not claimed an exemption regarding any of these funds on deposit. The Plan was established in accordance with @@ 145.71 through 145.74 of the Ohio Revised Code to serve as a program of deferred compensation which permits state government employees to defer receipt of a portion of their compensation to achieve certain tax benefits. The Plan was promulgated by the Ohio legislature pursuant to congressional authority set forth in 26 U.S.C. 457, which authorized the several states to create deferred compensation programs for eligible employees. The Ohio Plan, entitled "Ohio Public Employees Deferred Compensation Program", allows eligible government employees to participate upon their execution of a Participation Agreement. By so doing, the eligible employee consents to the terms of The Plan (State's Brief, Ex. 1, p. 2). The Plan becomes effective with a participating employee once he becomes an active participant by executing the Participation Agreement and not terminating the deferral of compensation. It is uncontested that the Debtor has made no withdrawals from the funds since they were deposited.

The issues for the Court's determination are (1) whether the funds on deposit in The Plan constitute property of the Debtor's estate; (2) If estate property, are the funds recoverable by the trustee. In seeking the turnover of funds, the trustee contends that the funds voluntarily contributed by the Debtor are estate funds and are not excludible pursuant to any provision of the Bankruptcy Code. He further contends that The Plan, as constituted, is not a trust, but if it is determined to be a trust, it is not a valid spendthrift trust under Ohio law. In support of The Plan's validity and its proposition that the subject funds are not estate assets, the State of Ohio relies on the provisions of 26 U.S.C. 457(b)(6) to assert that the Debtor does not hold any interest in the funds.

Section 541 of the Bankruptcy Code defines the

parameters of estate property. Therein, the Debtor's estate is comprised, *inter alia*, of all legal or equitable interests of the Debtor in property as of the commencement of the case. *See*, 11 U.S.C. 541(a). It also includes any interest in property which the estate acquires after the commencement of the case. *See*, 11 U.S.C. 541(a)(2) and (a)(7). Once property is determined to be estate property, it may be ordered turned over to the estate pursuant to @ 542 of the Bankruptcy Code.

In reaching a resolution of this matter, an examination of The Plan is warranted to determine whether the deferred compensation is an asset of the Debtor's estate. In other words, the Court must determine whether the Debtor has an interest in the deferred funds. Several observations support a finding of estate property. A good starting point is with the name of The Plan, "Ohio Public Employees Deferred Compensation Program." It is implicit from the wording of the title that a participant, such as the Debtor, has an interest in The Plan, as he is an eligible government employee. It is uncontested that the Debtor is an active, eligible participant in The Plan who has in excess of $ 3,500.00 credited to his Plan account as deferred compensation. As a depositor in a deferred compensation program, one can readily surmise that the Debtor or any such depositor has an expectancy of a return of investment at some future date as a result of the very purpose of this type of program. Even @ 1.01 of The Plan expressly indicates that the account maintained by the employer reflects the "interest" of a participant under The Plan. Section 1.09 of The Plan addresses an emergency withdrawal as defined under Plan @ 4.04 which refers to emergency withdrawals being allowed upon the occurrence of an "unforeseeable emergency." Remarkably, that same section allows a distribution from the "participant's" account which further evidences an interest of the Debtor in the deposited funds. Further, @ 1.12 of The Plan, addressing "Includible Compensation," makes clear reference to the fact that the account funds refer to "the amount of an eligible employee's compensation from the employer for the taxable year. Moreover, @ 3.04 of the Plan recognizes the Debtor's interest or relationship to the deferred assets held by the State by

characterizing the participant as a "general creditor" of the employer. Thusly, the aggregate of the above-referenced Plan sections clearly indicate that an active Plan participant such as the Debtor has a specific interest in the funds credited to his account.

Upon closer scrutiny, not only does an active Plan participant such as the Debtor possess an interest in the deferred compensation, the fund is accessible to the Debtor. Generally, where a plan's funds are accessible to a debtor, the debtor's estate is accorded no lesser access. See, *In re Lally,* 51 Bankr. 204, 205 (N.D. Iowa 1985). In the present Plan, credited deferred compensation may be distributed from The Plan, (1) upon an approved emergency withdrawal (@ 1.24);(2) separation from employment (@ 4.01); (3) attaining the age of 70-1/2 years (@ 4.01); or (4) upon a *de minimus* withdrawal (@ 4.05); 26 U.S.C. 457(e)(9). These withdrawal features are available in The Plan notwithstanding the fact that the present Debtor has not reached 70-1/2 years, is currently employed, and has not disturbed the corpus of his Plan account.

The State of Ohio relied upon 26 U.S.C. 457 to support its position that the Debtor had no interest in the deferred funds. Title 26 U.S.C. 457 does not diminish or avoid the Debtor's interest in the deferred Plan funds. As averred by the State, the Ohio Plan was promulgated pursuant to authority of @ 457 of the Internal Revenue Code. In relevant part, @ 457(b)(6) provides:

> @ 457(b) Eligible State Deferred Compensation Plan Defined. --- For purposes of this section, the term "eligible state deferred compensation plan" means a plan established and maintained by a State ---
>
> (6) which provides that ---
> (A) all amounts of compensation deferred under the plan,
> (B) all property and rights purchased with such amounts and

> (C) all income contributable to such amounts, property, or rights, shall remain (until made available to the participant or other beneficiary) solely the property and rights of the State (without being restricted to the provision of benefits under the plan) subject only to the claims of the State's general creditors.
>
> 26 U.S.C. 457(b)(6)(A)(B)(C).

The above-quoted language extracted from @ 547(b) of Title 26, United States Code, clearly provides that the active plan participant has, at a minimum, an inchoate interest in the deferred funds, but an interest nevertheless. Additionally, provisions of 26 U.S.C. 457(b)(6)(C) and the Ohio Plan @ 3.04 characterize plan participants as "general creditors", further evidencing an interest of the Debtor in the deferred funds. Therefore, pursuant to the provisions of @ 541(a) of the Bankruptcy Code, the Debtor's deferred income in The Plan constitutes estate property pursuant to 11 U.S.C. 541(a)(1).

II.

Once property has been determined by the Court as being estate property, the Court then must determine whether any provision of the Bankruptcy Code excludes that property from recovery by the Trustee.Section 541(c)(2) of the Bankruptcy Code [11 U.S.C. 541(c)(2)] provides:

> A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

Section 541(c)(2), as noted above, provides an exclusion from estate property where the debtor's beneficial interest in a trust is enforceable under applicable nonbankruptcy law. The phrase "applicable nonbankruptcy law," however, has been interpreted narrowly as a reference to state spendthrift trust law which is not applicable to the present matter. See, *Kaplan*

*v. Primerit Bank*, 97 Bankr. 572 (Bankr. 9th Cir. 1989); *Daniel v. Security Pacific National Bank*, 771 F.2d 1352 (9th Cir. 1985); cert. denied, 475 U.S. 1016, 89 L. Ed. 2d 313, 106 S. Ct. 1199 (1986); *Lichstrahl v. Bankers Trust*, 750 F.2d 1488 (11th Cir. 1985); *In re Graham*, 726 F.2d 1268 (8th Cir. 1984). Herein, it is undisputed that the Plan is not a trust. In fact, @ 3.04 of the Plan provides that "No trust fund, bailment, or other fiduciary relationship or property right shall be created by the existence of the Plan." Interestingly, it is the State of Ohio, not the Debtor, which asserts that the deferred funds are not property of the estate. Although the State makes no reference to @ 541(c)(2) in support of its argument, @ 541(c)(2) is the only provision which allows an exclusion of estate property under @ 541 of the Bankruptcy Code. For this reason, the excludability of the subject funds will only be considered in view of @ 541(c)(2).

An examination of the legislative history of @ 541(c)(2) reveals that it is derived from @ 4-601(b) of a report commissioned by the U.S. Congress.[1] In its deliberations on the Commission's Report, the Congress ultimately adopted a Commission proposal which provided that the definition of property not be tied to an assignability-leviability standard. See, *Graham, supra*. Moreover, the language of @ 4-601(b), while not defining a trust, specifically addressed itself to spendthrift and support trusts:

> Under @ 4-601 a beneficial interest in a support or spendthrift trust is made available to creditors, except to the extent income or principal is carved out as necessary to support the debtor. This equates the treatment of beneficial interests which the debtor did not create and could not transfer, voluntarily or involuntarily, with related exemptions, e.g., pensions. [Report of the Commission on the

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[1] Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93rd Cong. 1st Sess. (1973). See also, Dunham, D., "Pensions And Other Funds In Individual Bankruptcy Cases." Bankr. Dev. Jnl., Vol. 4 (1987).

> Bankruptcy Laws of the United States, H.R. Doc. No. 9-137, 93rd Cong. 1st Sess., @ 4-601(b), pt. II, at 147-48 (1973).

The apparent focus of the Commission's report in this regard was to develop a proposal which would be beneficial to the beneficiaries of a spendthrift or support trust — not to benefit a settlor or some other third party involved with the administration of one of these types of trusts. For example, @ 4-503(c)(6) of the Commission's proposal allowed the debtor to claim an exemption of his pension or other support fund. In relevant part, @ 4-503(c)(6) allowed an exemption:

> (6) before or after retirement, such rights as the debtor may have under a profit sharing, pension, stock bonus, annuity, or similar plan which is established for the primary purpose of providing benefits upon retirement by reason of age, health, or length of service, and which is either (A) qualified under section 401(a) of the Internal Revenue Code, or any successor thereto, or (B) established by federal or state statute, to the extent in either case the debtor's interest therein is reasonably necessary for the support of the debtor and his dependents . . . [Id., pt. I, at 125 (1973)].

This language of @ 4-503 was the apparent precursor for the present federal exemption provided under @ 522(d)(10)(E) of the Bankruptcy Code. The State of Ohio, one of a majority of states electing to opt-out of the federal bankruptcy exemption scheme, similarly allows an exemption for pensions and other support-type funds. See @ 2329.66, Ohio Revised Code. A review of the Debtor's statement of exemptions indicates no such exemption was taken in the present case. Pension benefits are specifically treated under the Code's exemption provision. *Graham, supra*, at 1272; *Goff v. Taylor (In re Goff)*, 706 F.2d 574 (5th Cir. 1983).

This legislative history of @ 541(c)(2) supported the Eighth Circuit's recent ruling on this issue which found that "541(c)(2) was intended to exclude a debtor's beneficial interest in a

'traditional' spendthrift trust, not a statutory retirement fund." *See, In re Swanson,* 873 F.2d 1121, 1123 (8th Cir. 1989). This Court adopts that view. The subject Plan is, in fact, not a spendthrift trust which would be excludible from the estate under @ 541(c)(2). It merely is a qualified deferred compensation program which was not intended to provide for the maintenance and support of its beneficiaries. As argued by the State, its purpose is to provide certain tax benefits to the Plan participant. Further disqualifying the Plan as a spendthrift trust is the fact that the contributions to the fund, at least in part, were made by the Debtor who also is the Plan beneficiary. A self-settled trust is, generally, not a valid spendthrift trust. *Id.*, at 1124; *In re Leimbach,* 99 Bankr. 796 (Bankr. S.D. Ohio 1989); *In re McCombe,* 93 Bankr. 597 (Bankr. S.D. Ohio 1988).

Conclusion

Accordingly, the deferred funds, to the extent contributed by the Debtor plus interest accrued thereon, are estate property pursuant to @ 541(a)(1) of the Bankruptcy Code. There existing no available exclusion of same under @ 541(c)(2), and no exemption having been declared, said funds are hereby ordered to be turned over to the trustee no later than twenty (20) days from the entry of this order.

IT IS SO ORDERED.

Dated this 1st day of March, 1990

At Cleveland, in said District, on this 1st day of March, 1990.A Memorandum Of Opinion And Order having been rendered by the Court in these proceedings, IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that judgment is rendered in favor of the Plaintiff.

11 USCS @ 541 (1992)

@ 541. Property of the estate

(a) The commencement of a case under section 301, 302, or 303 of this title [11 USCS @ 301, 302, or 303] creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

(2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is- (A) under the sole, equal, or joint management and control of the debtor; or

(B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

(3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title [11 USCS @ 329(b), 363(n), 543, 550, 553, or 723].

(4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title [11 USCS @ 510(c) or 551].

(5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date-(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or

(C) as a beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case.

(b) Property of the estate does not include-

(1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor;

(2) any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease before the commencement of the case under this title, and ceases to include any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease during the case; or

(3) any eligibility of the debtor to participate in programs authorized under the Higher Education Act of 1965 (20 U.S.C. 1001 et seq.; 42 U.S.C. 2751 et seq.), or any accreditation status or State licensure of the debtor as an educational institution.

(c)(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law-

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition

of the debtor, on the commencement of a case under this title [11 USCS @@ 101 et seq.], or on the appointment of or taking possession by a trustee in a case under this title [11 USCS @@ 101 et seq.] or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

(2) A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title [11 USCS @@ 101 et seq.].

(d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

TITLE 26. INTERNAL REVENUE CODE

26 USCS @ 457 (1991)

Sec. 457. Deferred compensation plans of state and local governments and tax-exempt organizations.

(a) Year of inclusion in gross income.In the case of a participant in an eligible deferred compensation plan, any amount of compensation deferred under the plan, and any income attributable to the amounts so deferred, shall be includible in gross income only for the taxable year in which such compensation or other income is paid or otherwise made available to the participant or other beneficiary.

(b) Eligible deferred compensation plan defined.

For purposes of this section, the term "eligible deferred compensation plan" means a plan established and maintained by an eligible employer —

(1) in which only individuals who perform service for the employer may be participants,

(2) which provides that (except as provided in paragraph (3)) the maximum amount which may be deferred under the plan for the taxable year shall not exceed the lesser of —

(A) $ 7,500, or

(B) 33 1/3 percent of the participant's includible compensation,

(3) which may provide that, for 1 or more of the participant's last 3 taxable years ending before he attains normal retirement age under the plan, the ceiling set forth in paragraph (2) shall be the lesser of —

(A) $ 15,000, or

(B) the sum of —

(i) the plan ceiling established for purposes of paragraph (2) for the taxable year (determined without regard to this paragraph), plus

(ii) so much of the plan ceiling established for purposes of paragraph (2) for taxable years before the taxable year as has not previously been used under paragraph (2) or this paragraph,

(4) which provides that compensation will be deferred for any calendar month only if an agreement providing for such deferral has been entered into before the beginning of such month,

(5) which meets the distribution requirements of subsection (d), and

(6) which provides that —

(A) all amounts of compensation deferred under the plan,

(B) all property and rights purchased with such amounts, and

(C) all income attributable to such amounts, property, or rights, shall remain (until made available to the participant or other beneficiary) solely the property and rights of the employer (without being restricted to the provision of benefits under the plan), subject only to the claims of the employer's general creditors.

A plan which is established and maintained by an employer which is described in subsection (e)(1)(A) and which is administered in a manner which is inconsistent with the requirements of any of the preceding paragraphs shall be treated as not meeting the requirements of such paragraph as of the 1st plan year beginning more than 180 days after the date of notification by the Secretary of the inconsistency unless the employer corrects the inconsistency before the 1st day of such plan year.

(c) Individuals who are participants in more than 1 plan.

(1) In general. The maximum amount of the compensation of any one individual which may be deferred under subsection (a) during any taxable year shall not exceed $ 7,500 (as modified by any adjustment provided under subsection (b)(3)).

(2) Coordination with certain other deferrals. In applying paragraph (1) of this subsection —

(A) any amount excluded from gross income under section 403(b) for the taxable year, and

(B) any amount —

(i) excluded from gross income under section 402(a)(8) or section 402(h)(1)(B) for the taxable year, or

(ii) with respect to which a deduction is allowable by reason of a contribution to an organization described in section 501(c)(18) for the taxable year, shall be treated as an amount deferred under subsection (a). In applying section 402(g)(8)(A)(iii) or 403(b)(2)(A)(ii), an amount deferred under subsection (a) for any year of service shall be taken into account as if described in section 402(g)(3)(C) or 403(b)(2)(A)(ii), respectively.

Subparagraph (B) shall not apply in the case of a participant in a rural cooperative plan (as defined in section 401(k)(7)).

(d) Distribution requirements.

(1) In general. For purposes of subsection (b)(5), a plan meets the distribution requirements of this subsection if —

(A) under the plan amounts will not be made available to participants or beneficiaries earlier than —

(i) the calendar year in which the participant attains age 70 1/2, (ii) when the participant is separated from service

with the employer, or (iii) when the participant is faced with an unforeseeable emergency (determined in the manner prescribed by the Secretary in regulations), and

(B) the plan meets the minimum distribution requirements of paragraph (2).

(2) Minimum distribution requirements. A plan meets the minimum distribution requirements of this paragraph if such plan meets the requirements of subparagraphs (A), (B), and (C):

(A) Application of section 401(a)(9). A plan meets the requirements of this subparagraph if the plan meets the requirements of section 401(a)(9).

(B) Additional distribution requirements. A plan meets the requirements of this subparagraph if —

(i) in the case of a distribution beginning before the death of the participant, such distribution will be made in a form under which — (I) the amounts payable with respect to the participant will be paid at times specified by the Secretary which are not later than the time determined under section 401(a)(9)(G) (relating to incidental death benefits), and (II) any amount not distributed to the participant during his life will be distributed after the death of the participant at least as rapidly as under the method of distributions being used under subclause (I) as of the date of his death, or

(ii) in the case of a distribution which does not begin before the death of the participant, the entire amount payable with respect to the participant will be paid during a period not to exceed 15 years (or the life expectancy of the surviving spouse if such spouse is the beneficiary).

(C) Nonincreasing benefits. A plan meets the requirements of this subparagraph if any distribution payable over a period of more than 1 year can only be made in substantially nonincreasing amounts (paid not less frequently than annually).

(e) Other definitions and special rules.

For purposes of this section —

(1) Eligible employer. The term "eligible employer" means — (A) a State, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State, and

(B) any other organization (other than a governmental unit) exempt from tax under this subtitle.

(2) Performance of service. The performance of service includes performance of service as an independent contractor and the person (or governmental unit) for whom such services are performed shall be treated as the employer.

(3) Participant. The term "participant" means an individual who is eligible to defer compensation under the plan.

(4) Beneficiary. The term "beneficiary" means a beneficiary of the participant, his estate, or any other person whose interest in the plan is derived from the participant.

(5) Includible compensation. The term "includible compensation" means compensation for service performed for the employer which (taking into account the provisions of this section and other provisions of this chapter) is currently includible in gross income.

(6) Compensation taken into account at present value. Compensation shall be taken into account at its present value.

(7) Community property laws. The amount of includible compensation shall be determined without regard to any community property laws.

(8) Income attributable. Gains from the disposition of property shall be treated as income attributable to such property.

(9) Benefits not treated as made available by reason of certain elections. If —

(A) the total amount payable to a participant under the plan does not exceed $ 3,500, and

(B) no additional amounts may be deferred under the plan with respect to the participant,the amount payable to the participant under the plan shall not be treated as made available merely because such participant may elect to receive a lump sum payable after separation from service and within 60 days of the election.

(10) Transfers between plans. A participant shall not be required to include in gross income any portion of the entire amount payable to such participant solely by reason of the transfer of such portion from 1 eligible deferred compensation plan to another eligible deferred compensation plan.

(11) Certain plans excepted. Any bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay, or death benefit plan shall be treated as a plan not providing for the deferral of compensation.

(12) Exception for nonelective deferred compensation of nonemployees.

(A) In general. This section shall not apply to nonelective deferred compensation attributable to services not performed as an employee.

(B) Nonelective deferred compensation. For purposes of subparagraph (A), deferred compensation shall be treated as nonelective only if all individuals (other than those who have not satisfied any applicable initial service requirement) with the same relationship to the payor are covered under the same plan with no individual variations or options under the plan.

(13) Special rule for churches. The term "eligible employer"

shall not include a church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)(3)(B)).

(f) Tax treatment of participants where plan or arrangement of employer is not eligible.

(1) In general. In the case of a plan of an eligible employer providing for a deferral of compensation, if such plan is not an eligible deferred compensation plan, then —

(A) the compensation shall be included in the gross income of the participant or beneficiary for the 1st taxable year in which there is no substantial risk of forfeiture of the rights to such compensation, and

(B) the tax treatment of any amount made available under the plan to a participant or beneficiary shall be determined under section 72 (relating to annuities, etc.).

(2) Exceptions. Paragraph (1) shall not apply to —

(A) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

(B) an annuity plan or contract described in section 403,

(C) that portion of any plan which consists of a transfer of property described in section 83, and

(D) that portion of any plan which consists of a trust to which section 402(b) applies.

(3) Definitions. For purposes of this subsection

(A) Plan includes arrangements etc. The term "plan" includes any agreement or arrangement.

(B) Substantial risk of forfeiture. The rights of a person to compensation are subject to a substantial risk of forfeiture if such person's rights to such compensation are conditioned upon the future performance of substantial services by any individual.

# TITLE I STATE GOVERNMENT

## CHAPTER 145
## PUBLIC EMPLOYEES RETIREMENT SYSTEM

### SUBCHAPTER PUBLIC EMPLOYEES DEFERRED COMPENSATION BOARD

**ORC Ann.** @ 145.71 (BALDWIN)

145.71 Definitions (A) "Eligible employee" includes any public employee as defined in division (A) of section 145.01, any person eligible to become a member under section 145.20, any employee as defined in division (C) of section 742.01, any employee as defined in division (B) of section 3309.02, any employee as defined in division (A) of section 5505.01 of the Revised Code, and any member of the state teachers retirement system.

(B) "Participating employee" includes any eligible employee who is having compensation deferred pursuant to contract, executed before such compensation is earned, with his employer and the public employees deferred compensation board.

(C) "Continuing member" includes any former participating member who is not currently having compensation deferred, or his beneficiary, to whom payment has not been made of all deferred compensation distributions.

(D) Notwithstanding section 145.01, the definitions of that section are applicable to sections 145.71 to 145.73 of the Revised Code only to any extent necessary to fully understand the provisions of such sections. Reference may also be to Chapter 742., 3307., 3309., and 5505. of the Revised Code for such purpose. EFF-DATE: 7-24-90

## TITLE I STATE GOVERNMENT

## CHAPTER 145
## PUBLIC EMPLOYEES RETIREMENT SYSTEM

### SUBCHAPTER PUBLIC EMPLOYEES DEFERRED COMPENSATION BOARD

**ORC Ann.** @ 145.72 (BALDWIN)

145.72 Deferred compensation board created; membership; powers

The Ohio public employees deferred compensation board shall be comprised of a member of the house of representatives and a member of the senate, who shall not be of the same political party, each to be appointed to serve at the pleasure of his respective leadership, and the members of the public employees retirement board as constituted by section 145.04 of the Revised Code, who are hereby created as a separate legal entity for the purpose of administering a deferred compensation system for all eligible employees. The public employees retirement board may utilize its employees and property in the administration of the system on behalf of the Ohio public employees deferred compensation board, in consideration of a reasonable service charge to be applied in a nondiscriminatory manner to all amounts of compensation deferred under this system.The Ohio public employees deferred compensation board may exercise the same powers granted by section 145.09 of the Revised Code necessary to its functions. The attorney general shall be the legal adviser of the board. EFF-DATE: 7-24-74

## TITLE I STATE GOVERNMENT

## CHAPTER 145
## PUBLIC EMPLOYEES RETIREMENT SYSTEM

## SUBCHAPTER PUBLIC EMPLOYEES DEFERRED COMPENSATION BOARD

**ORC Ann.** @ 145.73 (BALDWIN)

145.73 Duties of board

(A) The Ohio public employees deferred compensation board shall initiate, plan, expedite, and, subject to an appropriate assurance of the approval of the internal revenue service, promulgate and offer to all eligible employees, and thereafter administer on behalf of all participating employees and continuing members, and alter as required, a program for deferral of compensation, including a reasonable number of options to the employee for the investment of deferred funds, including life insurance, annuities, variable annuities, regulated investment trusts, pooled investment funds managed by the board, or other forms of investment approved by the board, always in such form as will assure the desired tax treatment of such funds.

(B) Every employer of an eligible employee shall contract with such employee upon application for his participation in a deferred compensation program offered by the board. Every retirement system serving an eligible employee shall serve as collection agent for compensation deferred by any of its members and account for and deliver such sums to the board.

(C) The board shall, subject to any applicable contract provisions, undertake to obtain as favorable conditions of tax treatment as possible, both in the initial programs and any permitted alterations thereof or additions thereto, as to such matters as terms of distribution, designation of beneficiaries, withdrawal upon disability, financial hardship, or termination of public employment, and other optional

provisions.

(D) In no event shall the total of the amount of deferred compensation to be set aside under a deferred compensation program and the employee's nondeferred income for any year exceed the total annual salary or compensation under the existing salary schedule or classification plan applicable to such employee in such year. Such a deferred compensation program shall be in addition to any retirement or any other benefit program provided by law for employees of this state. The board shall adopt rules pursuant to Chapter 119. of the Revised Code to provide any necessary standards or conditions for the administration of its programs, including any limits on the portion of a participating employee's compensation that may be deferred in order to avoid adverse treatment of the program by the internal revenue service or the occurrence of deferral, withholding, or other deductions in excess of the compensation available for any pay period. Any income deferred under such a plan shall continue to be included as regular compensation for the purpose of computing the contributions to and benefits from the retirement system of such employee. Any sum so deferred shall not be included in the computation of any federal and state income taxes withheld on behalf of any such employee.

(E) This section does not limit the authority of any municipal corporation, county, township, park district, conservancy district, sanitary district, health district, public library, county law library, public institution of higher education, or school district to provide separate authorized plans or programs for deferring compensation of their officers and employees in addition to the program for the deferral of compensation offered by the board. Any municipal corporation, public institution of higher education, or school district that offers such plans or programs shall include a reasonable number of options to its officers or employees for the investment of the deferred funds, including annuities, variable annuities, regulated investment trusts, or other forms of investment approved by the municipal corporation, institution of higher education, or school district, that will assure the desired tax treatment of the funds. EFF-DATE: 9-20-84

# TITLE I STATE GOVERNMENT

## CHAPTER 145
## PUBLIC EMPLOYEES RETIREMENT SYSTEM

### SUBCHAPTER PUBLIC EMPLOYEES DEFERRED COMPENSATION BOARD

**ORC Ann. @ 145.74 (BALDWIN)**

145.74 Certain units may offer additional programs; reasonable number of options

As used in this section:

(A) "Government unit" means a county, township, park district of any kind, conservancy district, sanitary district, health district, public library district, or county law library.

(B) "Governing board" means, in the case of the county, the board of county commissioners; in the case of a township, the board of township trustees, in the case of a park district, the board of park commissioners; in the case of a conservancy district, the district's board of directors; in the case of a sanitary district, the district's board of directors; in the case of a health district, the board of health; in the case of a public library district, the board of library trustees; and in the case of a county law library, the board of trustees of the law library association.

In addition to the program of deferred compensation that may be offered under sections 145.71 to 145.73 of the Revised Code, a governing board may offer to all of the officers and employees of the government unit not to exceed two additional programs for deferral of compensation designed for favorable tax treatment of the compensation so deferred. Any such program shall include a reasonable number of options to the officer or employee for the investment of the deferred funds, including annuities, variable annuities,

regulated investment trusts, or other forms of investment approved by the governing board, that will assure the desired tax treatment of the funds.

Any income deferred under such a plan shall continue to be included as regular compensation for the purpose of computing the contributions to and benefits from the officer's or employee's retirement system but shall not be included in the computation of any federal and state income taxes withheld on behalf of any such employee. EFF-DATE: 9-20-84

# 145 PUBLIC EMPLOYEES RETIREMENT SYSTEM

## 145:1 PUBLIC EMPLOYEES DEFERRED COMPENSATION BOARD

### Chapter 145:1-1 General Provisions

### OAC 145:1-1-01 (Baldwin)

(A) The purpose of this rule is to provide all necessary standards or conditions for the administration of the Ohio public employees deferred compensation program created by sections 145.71 to 145.73 of the Revised Code.

(B) The following terms, when used herein, shall have the designated meaning unless a different meaning is plainly required by the context.

(1) "Program" — The Ohio public employees deferred compensation program as set forth in sections 145.71 to 145.73 of the Revised Code.

(2) "Board" — The Ohio board established pursuant to section 145.72 of the Revised Code for the purpose of administering the program.

(3) "Employer" — The state and various political subdivisions whose employees are permitted under division (A) of section 145.71 of the Revised Code to participate in the program.

(4) "Eligible employees" — Those employees defined in division (A) of section 145.71 of the Revised Code.

(5) "Employer agreement" — An agreement between an eligible employer and the board designed to facilitate the board's common administration of all employer plan agreements adopted under the program.

(6) "Plan(s) or plan agreement(s)" — The document adopted by an eligible employer under the program which sets forth the terms and conditions governing the deferral of an eligible

employee's compensation.

(7) "Participating employees or participants" — Those eligible employees who have elected to defer a portion of their compensation pursuant to a participation agreement.

(8) "Participation agreement" — The agreement between the eligible employer and the eligible employee by which an eligible employee adopts the plan agreement and elects to become a participating employee under the plan.

(9) "Investment index (indices)" — Those investment indices selected by a participating employee under the program which determine the level of benefits payable to a participating employee.

(10) "Funding agents" — Those insurance companies, banks and other financial institutions which the board shall select to invest compensation deferred under plans adopted under the program.

(11) "Funding media" — Those insurance policies, investment funds, mutual funds, annuities, variable annuities, regulated investment trusts, pooled investment funds or other forms of investments managed or issued by the funding agents and selected by the participants as investment indices and, into which compensation deferred under an eligible employer's plan is invested by the board on behalf of such eligible employer.

(12) "Participant's account" — An account maintained by the board evidencing those monies deferred by participating employees under a plan adopted under the program which are transmitted to the board by an eligible employer for investment in the funding media.

(13) "Payroll center(s)" — Those facilities where the participating employees' paychecks are computed and issued.

(14) "Retirement system" — The public board or authority which administers the pension fund of the participant's employer.

(C) The board or its designees shall observe the following procedures in implementing and administering the program.

(1) The board shall, with the advice and assistance of counsel, formulate and design plan agreements for adoption by those eligible employers electing to offer a plan of deferred compensation to their eligible employees under the program.

(2) The plan agreements prepared by the board shall be designed to obtain the desired federal and state income tax treatment of all amounts deferred by a participating employee under the plan agreement. The plan agreement may be amended from time to time, to reflect those changes which are necessary to assure the desired tax treatment and the proper administration of the individual plans under the program. The limit on the portion of a participating employee's compensation that may be deferred shall be the maximum annual deferral permitted under section 457 of the "Internal Revenue Code," or any other applicable section of the "Internal Revenue Code," provided that such a limit does not cause a reduction of compensation in any given pay period which is greater than the amount of compensation available for such pay period.

(3) The board shall advise all eligible employees of the existence of the program and shall supply them with sufficient information to assist them in determining whether to participate in the program. Each employer shall execute an employer agreement upon an eligible employee's application to participate in a plan under the program. The employer shall assist the board in communicating the availability of the plan to all eligible employees including any personal explanation prepared and deemed necessary by the board for an eligible employee to make an informed decision regarding his right to participate. The different funding media into which the participating employees' deferred income may be invested shall be fairly and impartially presented to the

eligible employees. The employer's payroll centers shall recompute the participant's income as specified in the participation agreement and shall remit such deferred amounts to the retirement system serving such participant which in turn shall deliver such amounts to the board.

(4) Each eligible employee who elects to participate under a plan of deferred compensation established by an elibible [sic] employer under the program, shall execute a participation agreement by which he becomes a member of the plan. The board shall undertake to provide all the necessary services required to implement, offer and administer the program on behalf of the eligible employer, and shall be empowered in the employer agreement to perform any and all acts incidental to the administration of the plan.

(5) The board shall contract with those funding agents whose funding media are selected by the board to serve as investment indices under plans adopted under the program. The board's contract with such funding agents shall provide that all amounts deferred under plans adopted under the program will be invested by the board with the funding agents for the period of time that the investment index is made available under an eligible employer's plan and is selected by the participating employee.

(6) All plan assets shall be held by the board on behalf of the eligible employer and shall at all times be the assets of the employer and not the assets of the participating employees or the board. To facilitate administration of the program, the board shall create individual participant accounts, bearing the participant's name, but all assets of plans under the program shall be the exclusive property of the employer. The board shall issue to the participating employees, on behalf of the employer, at least annually, a statement of account values, setting forth the value of a participating employee's account as of such date. All information regarding a participant's account shall be confidential.

(7) The board, on behalf of the employer, may assess a participant's account to pay the cost of administering the plan adopted under the program. Interest earned on any employer's funds prior to investment with the funding agent may be applied by the board to fund any costs incident to the operation of the program.

(8) The board may at any time direct the funding agents to distribute benefits payable to the participants or their beneficiaries in the manner the board designates and in accordance with the payment option selected by a participant in the participation agreement.

(9) If any plan is curtailed, terminated, or the acceptance of additional deferred amounts suspended permanently, the board shall nonetheless be responsible for the supervision and the payment of all participant benefits under such plan.

(10) The board is authorized to decide or to resolve any questions of fact regarding a participant or his deferred account needed or necessary to decide the participant's rights under the program and such decision is final and binding on the participant and any beneficiary thereof.

(11) The participant shall not be permitted to seek recovery against his employer, the board or any other participant, contractee or agent of the board, or as against any other person having an administration or investment position relative to the program, for any loss, if any, sustained by the participant or his beneficiary, for the nonperformance of their duties, negligence, or any other misconduct of the above-named persons except that such persons shall not be excused from fraud or any wrongful taking of the participant's property.

(D) If any paragraph, term or provision of this rule shall be adjudged invalid for any reason, such judgment shall not affect, impair, or invalidate any other paragraph, term or provision of this rule, but the remaining paragraphs, terms and conditions shall be and continue in full force and effect.